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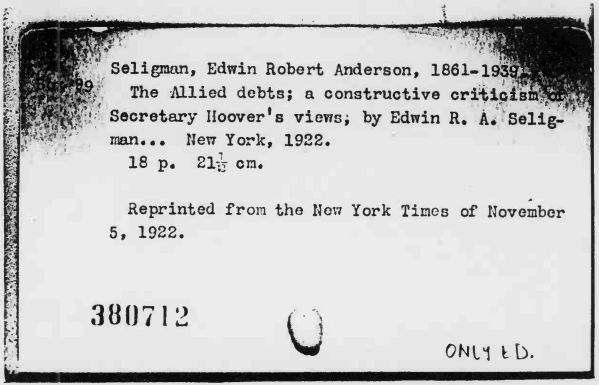

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THE ALLIED DEBTS

A Constructive Criticism of Secretary Hoover's Views

BY

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THE ALLIED DEBTS

In a speech at Toledo on Oct. 16 Secretary Hoover, a member of the Allied Debt Commission, gave his views, which presumably represent the policy of the commission as well as of the Government. There is no doubt, however, that there is a growing sentiment in the country which is not in harmony with the views of Mr. Hoover—a sentiment which is entertained by an increasing number not only of business men, but also of farmers and labor leaders. Mr. Hoover's views, moreover, are contrary to those expressed by Mr. Lamont and Mr. Krech at the recent Bankers' Convention in New York.

It may be worth while, therefore, to pass in review the arguments adduced by Mr. Hoover, and to attempt a constructive criticism of a public servant who stands so deservedly high in the affections of the community. In the discussion of the allied debt there are three fundamental points. The first is the character of the obligations; the second refers to the ability of the debtors to pay, and the third has to deal with the desirability on our part of insisting on immediate or early settlement. Let us take these points in order:

I.

Is the Allied Debt a Just Debt?

Mr. Hoover starts with the following statement: "These loans were made at the urgent request of the borrowers and under their solemn assurances of repayment. They have no relation to other nations or other debts. The American taxpayer did not participate in reparations and acquired no territory or any other benefits under the treaty, as did our debtors. There is no doubt as to the moral or contractual obligation. The repudiation of these loans would undermine the whole fabric of international good faith. I do not believe any public official, either of the United States or any other country, could or should approve their cancellation."

As to the contractual obligation, there can, of course, be no question. The money was borrowed at the request of the Allies; it was loaned in good faith, and it indubitably constitutes a valid debt. But is the question of moral obligation the same? In the first place, contrary to widespread opinion, the loans to the Allies were to an overwhelming extent made during the war itself. Although private individuals loaned money to the belligerents, not a cent was advanced by the Government until we entered the war. And while it is true that comparatively small amounts were lent after the armistice, those loans were made almost entirely for expenses contracted during the war.

Of the total amount of about ten billions, there was loaned to Belgium after the signing of the treaty of peace in June, 1919, up to Nov. 15, 1919, only $3,000,000, and up to Nov. 15, 1920, another $10,000,000. To France about $250,000,000 was loaned from the date of the signing of the treaty to Nov. 15, 1919, and another $110,000,000 in the next year. To Italy between the signing of

the treaty and Nov. 15, 1919, the total advances were a little under $60,000,000, and another $50,000,000 between that date and Nov. 15, 1920. To Great Britain nothing at all was loaned in either period. Thus, substantially, the entire amount was advanced during the war.

Now, what was the object of these loans? As Secretary McAdoo has told us in his report for the fiscal year ended June 30, 1919: "It is difficult to exaggerate the great purposes served and the great results accomplished by these advances to foreign Goverments. In the most critical stage of the war they immeasurably assisted America's gallant associates in obtaining the munitions, supplies and equipment that were so imperatively needed to meet the enemy's offensives or to carry the fighting into his territory, and probably of equal importance was the fact that they served to hearten the allied armies and peoples by the knowledge that the vast credit resources of the United States were being shared with them for the effective prosecution of a common cause. Conversely, it it not difficult to estimate the disheartening effect that these loans of billions and willingness of America to lend for the prosecution of the war as much more as was needed, to the limit of her ability must have had upon the spirit and morale of the peoples and armies of the enemy. * * * * *The service of these loans in assisting to hold the battlefronts of Europe until the might of our heroic army could be felt effectively,* made possible, beyond the shadow of a doubt, the ending of the war in the Fall of 1918. Without this aid to the allied Governments the war unquestionably would have been prolonged, if not lost, with the resultant great additional cost in life and treasure."

In other words, as the sentence italicized by me shows, most of the money was loaned and the proceeds used to carry on a joint enterprise during a time when our aid in the

shape of actual combatants was insignificant. If the war was a joint enterprise, carried on for a common purpose, is there any more reason to separate the financial contribution than the human contribution? When we finally put our army under the orders of Foch we fused our efforts with those of our allies and gave an indelible stamp to our common efforts. If we are to charge France and Italy for the wheat that kept their forces alive, for the uniforms that kept their soldiers warm while they held the battlefront, we might as well charge so much a man for the American Army when it finally arrived.

What actually happened was that the Allies furnished a huge armed force which only with difficulty withstood the onset of the enemy. In this huge force the human element was represented primarily by France and Italy; the materials were furnished largely by Great Britain; and the food was contributed chiefly by the United States. All three elements were indispensable to the winning of the war: the absence of any of them would have spelled disaster. The mere fact that our chief contribution was rendered in the shape of book credits must not be permitted to obscure the facts.

It is true that we entered the contest with clean hands and with clean hearts; we poured out lavishly our treasures and the lives of our soldiers, we had nothing material to gain from victory and we sedulously refrained from even advancing any claim to the division of the spoils. So far, so good. But consider the other side for a moment.

Mr. Hoover tells us that America did not participate in reparations and acquired no other benefits under the treaty. It is indeed true that we acquired no benefits under the treaty, but is it true that we acquired no benefits from the war? It not the reverse the fact? While all Europe was in a death grapple we, as the most important neutral, remained aloof and earned incalculable sums.

At the very outset of the war Europe sent us millions of gold to pay for our supplies, and within a short time the flood of materials which we sent abroad created such a prodigious European indebtedness that it changed the United States from the chief debtor nation of the world to the chief creditor nation. The fortunes made in this country were stupendous; wages rose precipitately, and while Europe was in the throes of convulsions we reached the dizzy heights of untold prosperity. Is it, then, fair to urge that we made nothing out of the war?

On the contrary, this country has been the greatest beneficiary of the war. We received, indeed, no ships to ruin our shipping trade, as was the case in Great Britain; we received no colonies which would have been burdens rather than assets; but we heaped up wealth, while all other countries lost it.

The revolution which converted us from a debtor to a creditor nation, and which made us at a blow the economic arbiter of the world, is due to the fact that we received these enormous profits. Had we been in the war from the beginning we also should now have been hovering on the brink of bankruptcy. Instead of being able to count the ten billions as assets, our Government probably would have been in the position of owing ten times ten billions as our share of the cost of the war.

And, now, after having escaped all these dangers, after having made enormous profits out of the contest, after having emerged as the real beneficiary of the war, we have the hardihood to say that our relatively insignificant cash contribution,—all of which, incidentally, was expended in this country and went to enrich our people,—constitutes a debt which we have the moral right to exact from those who fought by our side and who suffered for the common cause —that is, for our cause—sacrifices incalculably greater than our own!

How are we to explain the almost simultaneous appearance of war-profits taxes in every country if not on the ground of conviction that it is illicit for an individual to make profits out of the blood and misery of his fellow countrymen in so fearful a crisis? But if it is indefensible for a private individual to retain all or even a large part of such profits, why is not the same rule applicable to a nation? What moral right have we to retain the profits that have been gained indeed, but not really earned, in such warfare?

Is the allied debt, then, a just debt? We advanced the money, indeed, in the form of loans, and legally our position is impregnable. What we actually did, however, was to defray our share of a common burden which, if it were to be adjusted on a truly equitable basis, would make us not the creditor but the debtor of the allied group. To insist now on our pound of flesh is to take the part of a Shylock standing on his legal rights, not of a high-minded partner in a joint common enterprise.

When Mr. Hoover tells us that the Allies gave us their solemn assurance of repayment, he is undoubtedly correct. When a man borrows money he always avers his intention to repay. But it may be questioned whether any of the Allies seriously thought at that time of repayment. It may even be questioned whether any one in our Government seriously contemplated repayment. The situation was so urgent and the crisis so profound that if the Allies had asked for gifts or contributions instead of loans they would have been given the funds just as readily. We know now that England had come absolutely to the end of her tether. Washington knew it then. When we sent our millions of boys to fight we did not stop to dicker whether this was to be a gift or a loan. What was true of the lives of our soldiers would have been equally true of the guns, the airplanes, and the uniforms which they so sorely needed. We made the loans because the Allies asked for loans; had they asked for gifts, we should have been equally ready to comply.

Finally, when Mr. Hoover says he does not believe that the public officials of any country approve the cancellation of the debts, he must be sorely misinformed as to the point of view of nearly every prominent European statesman. It is true that Great Britain has been goaded by our ungenerous attitude into the position where she declares her intention to repay every penny; for, like every proud debtor, Great Britain cannot endure the thought of being twitted with an unpaid debt. But let us not forget that Great Britain loaned to her allies almost twice as much as she borrowed from us, and that every responsible statesman in Great Britain would be only too glad of a comprehensive plan whereby she could be relieved of her debt to us and thus be put in position to forego the still larger debts due to her by the other Allies.

From the point of view of the equities of the case, therefore, can the debt of the Allies be called a just debt? We have every legal right to demand it, but from the higher point of view have we a moral right? We emerged from the stupendous struggle with clean hands, indeed, but with full hands. We are the one nation in the world which has profited by the war. Is it not almost like adding insult to injury to ask those who suffer the most and who bore the brunt of a common enterprise to suffer still more in order to enrich us further?

II.

Can Europe Pay?

Inasmuch, however, as the debt is undoubtedly a legal obligation, the question arises as to the ability of the debtors to pay. Here we must not fool ourselves. Technically, we are confronted by one solvent debtor and by a number of embarrassed debtors. Practically, however, our real debtors are all of them in the second category; for our real debtors are France, Italy, Belgium, and a dozen or more of the other countries. Almost one-half of the principal of the ten billions, is, indeed, owing to us by Great Britain; but while Great Britain was borrowing from us, she was lending still more to France, Italy, Russia, and the other Allies. She was able to make these loans because of the advances made by us. In effect Great Britain served simply as a channel through which we made loans to the Continental Allies; the ten billions went to the Continent, although part of it went there through an indirect and devious route *via* Great Britain. The question, therefore, resolves itself into this: Can the Continental countries pay the debts? Are they in any position to do so?

Mr. Hoover tells us that the interest and amortization charges upon the debts amount to only from 2 to 12 per cent. of their annual income. But if what has just been stated is true, and if our insistence on payment of Great Britain puts her into the unfortunate position of demanding payment from the other Allies, Mr. Hoover's figures must be at least doubled. The Allies will be called upon to pay not from 2 to 12 per cent. of eheir annual income, but from 4 to 24 per cent. And 24 per cent. cannot be considered a negligible sum, especially when it is the last straw that breaks the camel's back.

In the next place, Mr. Hoover attempts to controvert

the proposition that countries must pay their debts primarily through an exportable surplus, that is, through the exportation of raw materials or manufactured goods. I have the highest regard for Mr. Hoover as a statesman and administrator, but I respectfully submit that his economics in this respect are not sound. A far better analysis of the situation is to be found in the address of Mr. McKenna. Let us consider more closely how international debts can be paid.

First, of course, they can be paid in cash, i. e., in gold. This method of disposing of the allied debts can, however, be eliminated because the Continental nations have no gold to speak of. The great mass of the world's gold supply is in the United States.

The second possible method of paying a nation's debts is by turning over domestic property to the foreign creditor. Where the creditor is the Government, which of course cannot retain the property that may come into its possession, but must dispose of it to private individuals, it is clear that if the lands, railroads, or factories abroad were turned over to our Government in payment of the debt the Government would have to dispose of them to individual investors. But why should American citizens invest in European lands, railroads, or factories under the present conditions, with the prospects of endlessly increased taxation and decreasing incomes staring them in the face?

The political impossibility of the situation, moreover, is obvious. No self-respecting nation would allow absentee ownership of all its land and industries; and, on the other hand, no nation would look with favor on the investment by its own citizens in an immense amount of property abroad, which would make them waver in their allegiance because of their economic interests. Politically as well as economically, the attempt to pay debts by the transfer of one nation's property to another is excluded.

We come, in the third place, to the so-called "invisible items" on which Mr. Hoover lays so much stress. That these items exist is undoubted. In all international financial relations we have to deal with the money in the possession of, or remitted by, immigrants; with sums expended by tourists; with profits on shipping; with bankers' commissions; with insurance premiums, and with interest on investments. Every elementary textbook of economics makes allowance for these. Ever since the time of Cairnes we have made the distinction between the balance of trade and what is known as the equilibrium of commerce. The balance of trade which refers only to imports and exports of commodities is a familiar concept. Exports must offset imports, import must offset exports. If there is a surplus of exports over imports, we speak of a favorable balance of trade. But the equilibrium of commerce is a different matter.

Because of the existence of the so-called invisible items, the debits and credits between any two countries generally stand at an equilibrium when there is a definite excess either of exports or of imports. Great Britain before the war, for instance, received such immense sums as interest, freight, bankers' commissions, insurance premiums, *etc.*, that its commerce with foreign countries as a whole was in equilibrium when she imported several hundred million dollars more than she exported. Her debits and credits in international trade were equilibrated through an excess of imports. Her imports were paid for by her exports plus her profits. The excess of imports was due to profits consisting of these invisible items.

It is clear, therefore, that the existence of these invisible items does not disclose any added capacity on the part of a country to pay debts. If we start with a commercial equilibrium which includes these invisible items, the only way to pay a debt is to export more goods or more securities.

How was France enabled to pay her debt to Germany in 1870? First, of course, she had a large stock of gold which she turned over. Then she issued a great internal loan, the proceeds of which she remitted through the medium of bills of exchange. But the most effective method of payment was by immensely increasing her exports. The equilibrium of commerce between France and the outside world for the period prior to 1870 was, as in England, attained at a point where the imports exceeded the exports, the excess of imports representing profits on foreign investments. After 1870, however, the equilibrium of commerce stood at a point where the excess of imports was converted into a large excess of exports. France was able to pay the debt because her productive powers enabled her to convert an excess of imports into an excess of exports and to apply this excess to her indebtedness. Mr. Hoover's treatment of so-called "invisible items" fails to make this distinction between the normal balance of trade and the new equilibrium of commerce.

What is the situation in the Continental countries of Europe? They have no gold to remit. They cannot send us their land, railroads or factories. They have no more securities of foreign countries to turn over, as England did during the war. There is no likelihood of any substantial increase in the invisible items which they could transfer to us. On the contrary, in the present perilous economic situation there is slight probability of their receiving additional sums on foreign investments or profits on a larger merchant marine, or gains through developing banks or insurance companies; and the sums yielded by a possible increase in American travelers abroad or in the sums remitted by immigrants to this country would be only a drop in the bucket.

It remains true, therefore, despite Mr. Hoover's statement, that the only way in which a foreign debt of any

magnitude can be paid is through an exportable surplus. This means two things: First, that there is a surplus of social income; second, that the surplus take the form of exports.

In the present situation in Europe, however, there is no surplus of social income, and is not apt to be for a long time. People are prone to forget the gigantic ravages of war; never before in history has there been such prodigious waste of man-power and of capital. Despite the slight improvement that is visible now, Europe has on the whole been steadily going down hill. Even in Great Britain the most competent thinkers maintain that Great Britain is living on her capital, and is not forging ahead. Certainly the Continent of Europe as a whole is, economically speaking, bankrupt, and it will be a long time before the social income and outgo balance each other. And, in the second place, even when there is again a social surplus, the possibility of putting this surplus into exports will depend on unpredictable competitive conditions.

On one point, indeed, we may thoroughly agree with Mr. Hoover. Until Europe takes energetically in hand the question of expenditures, both government and individual, there is little hope. This means the stoppage of waste and the substitution of thrift for the riotous profligacy which has been the inevitable concomitant of war. It means, in Government finance, a drastic reduction of expenditures and the substitution of international co-operation for the sharp lines of extreme nationalism that have been drawn all over the Continent.

But the accomplishment of this task depends on political forces. There is no hope of great decrease of armaments until a sense of security replaces the present feeling of suspicion. Again, it comes with especially bad grace from us in the United States, who have enacted one of the most

extreme protective tariffs in our history, to preach free trade and international amity to Europe. Certainly, insistence by us on the immediate payment of debts will make matters worse than they now are. Can we blame France for saying that, if the United States and Great Britain demand payment in full of the indebtedness, she will certainly not be overgenerous in her demands for reparations from Germany? Reparations and allied debt payment are inextricably intertwined.

The truth is that our debtors are bankrupt. They cannot pay now, and will not be able to pay in any assignable time. I have found no prominent business man or banker here or abroad who believes that there is any possibility of paying the debts. You cannot extract water from a stone.

III.

Will it Benefit Us to be Paid?

But even if the Allies could pay, the final question arises: Should we demand that they pay now and forthwith? If they have the ability to pay, have we the capacity to receive?

Mr. Hoover seeks to answer this question in the affirmative by telling us of the three-cornered trade; of the fact, familiar to every tyro, that a nation in international trade may acquit its obligations to another country by transferring the debits to a third country, which stands in an opposite relation. Mr. Hoover endeavors to quiet our fears about the danger of European countries exporting to us a surplus of manufactured goods, which would stop the wheels of our industry, by saying that this surplus may come in the shape not of competitive goods but of raw materials which we need—rubber, silk, coffee, cocoa, or what not.

When I read this section of Mr. Hoover's speech I had

to rub my eyes in astonishment. For, as it is clear on reflection, there is a fallacy in the argument. Will Europe be able to send more manufactures to the tropics unless she has an exportable surplus? And how will an increase of European exports create a proportionate augmentation in the capacity of the tropics to supply, or in the readiness of the United States to demand, more raw materials? Let us concede, however, that the tropical countries will send us more rubber, tin, silk or coffee, and that the European debtors will send their manufactured goods to the tropics instead of to the United States. What will then happen, may I ask, to our exports of agricultural implements, electrical apparatus and textiles to China, South America and Africa? If the rubber and coffee are sent out by them to pay for more industrial products received from Europe, what will there be left with which to buy industrial products from the United States? It makes very little difference to us whether the wheels of industry are stopped here because of the plethora of exports of manufactured goods from Europe into the United States or because of the inability of the United States to send its wares to the tropics. In both cases there will be a falling-off in the demand for our products.

No explanation can obscure the fact that, despite the three-cornered trade, a nation's commerce must be envisaged as a totality. If the rest of the world pays a debt by exporting more goods, whether to us or to another country, it makes it harder for us to export the usual quantity of goods in return. The reason why, under normal conditions, exports are mutually profitable, is that the exporting country is thereby enabled to secure imports, that is, to buy commodities. It is a matter of give and take. But when, in order to pay an immense debt, the rest of the world has to increase its exports to us, there is nothing to call for imports in return; and with this cessation of our exports to foreign countries our factories will close, our industries will languish and a period of business depression will set in.

The most striking example of this state of affairs in international trade is the recent transfer of the German merchant marine to Great Britain. The average man thought that that would be a great thing for Great Britain, since she was getting something for nothing. But what was the result? First, there was such a drop in freight rates that stagnation was brought into the shipping business. Secondly, shipbuilding in England fell off to such an extent as to lead to a crisis in the industry, with a wave of unemployment sweeping over the country. Instead of being a blessing, it proved to be a disaster.

What is the real trouble in the United States, with wheat at a little over $1 a bushel and with depression in our industry? How long will it be before the American farmer realizes that our debtors are also our customers, and that we cannot expect any resumption of prosperity unless there is a market in which to sell our wares? Even if it were possible to compel our Allies to pay their debts, it would make the situation here still worse. In business life the best way to deal with a bankrupt creditor is to set him on his feet again. But there is a difference between public and private business. In private business, even if the bankrupt is not put on his feet, the creditor can at least find new customers and continue to dispose of his output elsewhere. In public business and finance, as in the present situation, it is different: we must either convert these bankrupt nations into good customers or have no customers at all. By saving them we save ourselves.

The trouble with the Debt Commission law is that the hands of the commission are tied. It was a concession to the ignorance and the prejudice of the average voter.

While I am sure that Mr. Hoover is entirely sincere in his belief, I suspect that he is largely, even if unconsciously, influenced by the politics of the situation and what he believes to be the general sentiment of the country. The situation here is analogous to that in France, where the business men and the economists will tell you privately that they do not at all agree with the views ennuciated by the politicians who fear to brave the popular wrath. What we need in this country is a more thorough study of what Mr. Hoover concedes to be the complex elements in the problem. When that study is made, it will in my judgment lead the American people to the conclusion that they cannot afford to press for an immediate repayment of the debt, or even for such a refunding as is contemplated in the law.

It may indeed be just as well to keep the debt on the books for a time. We have ample precedent for this, as in the case of the Turkish debt owing to Russia before the war. It may be good politics occasionally to remind our debtors politely of the fact that there is a debt. But would it not be both generous and wise for us to co-operate with our debtors in some project which would look to the utilization of those debts as a means of construction of a shattered world?

The debt cannot be paid, and if it could be paid it would harm us more than our debtors. As a matter not simply of equity, but of good business, let us study the matter further. We must not harbor the delusion that we can any longer be sufficient unto ourselves alone. More and more we shall have to depend on our exports, whether of raw materials or of manufactured products. Let us not, in the excess of our zeal, kill with one stone two birds each of which we should seek to keep alive—the one, the hope of European regeneration in the interests of a broad humanity; the other, our own prosperity, which will surely be imperiled by the ruin or the ill-will of our best customers.

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